**Recent Developments: Dodd-Frank and Sarbanes-Oxley Whistleblower Law**

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1. **Introduction**
   1. Office of Internet Enforcement is born in 1995.
      1. 1995 – John Stark notices people being victimized by securities fraud in Yahoo chat rooms and similar places.
      2. Novel evidence-collection issues:
         1. how to subpoena documents from AOL;
         2. IP addresses were new; what did they mean?
      3. He proposes that the SEC’s Enforcement Division establish an Office of Internet Enforcement to police that dark corner of the market. He writes a 30-page manifesto and is told, “Fine. You’re the Office of Internet Enforcement.”
      4. One of the things he proposed was that the Commission establish an email address to receive tips and complaints about potential federal securities law violations.
      5. Question arises: who’s going to read the emails?
   2. **Insider Trading Bounty Program**
      1. Was in place for 20 years but was little used.
      2. Section 21A(e) of the Exchange Act.
         1. Part of the Insider Trading and Securities Fraud Enforcement Act of 1988 (post 1987 crash).
         2. Authorized the SEC to award a bounty to a person who provides information leading to the recovery of a civil penalty in an insider trading case.
         3. All bounty determinations were within the sole discretion of the Commission, but the total bounty could not exceed 10% of the amount recovered from a civil penalty.
   3. **Problem in government with respect to information sharing**.
      1. 9/11
      2. Umar Farouk Abdulmutallab – Nigerian national on airplane in Dec. 2009
      3. SEC
         1. Peter Scannell – Putnam Investments
         2. Bernie Madoff
   4. **Sarbanes-Oxley Section 806**
      1. Does not include a bounty provision, only anti-retaliation protections.
      2. A “whistleblower” is an employee of a public company who provides information regarding any conduct that the employee reasonably believes constitutes a violation of:
         1. any rule or regulation of the SEC;
         2. federal criminal provisions relating to securities, bank, mail, or wire fraud; or
         3. any federal law relating to fraud against shareholders.
      3. An employee who provides such information to a federal regulatory or law enforcement agency, to a member or committee of Congress, or to a person with supervisory authority over the employee is protected. 18 U.S.C. § 1514A.
      4. **Procedure**
         1. An employee who believes he or she has been discharged, demoted, suspended, threatened, harassed, coerced, or blacklisted as a consequence of whistleblowing may file a complaint with OSHA.
         2. Deadline was previously 90 days, but after Dodd-Frank it’s 180 days. 18 U.S.C. § 1514A(b)(2)(D).
         3. If Sec’y of Labor fails to issue a final decision within 180 days of the filing of the complaint, the complainant may bring an action for de novo review in federal district court. 18 U.S.C. § 1514A(b)(1)(B).
      5. ***Prima facie* case**
         1. Employee engaged in a protected activity;
         2. Employer knew or suspected that the employee engaged in a protected activity;
         3. Employee suffered an unfavorable personnel action; and
         4. The circumstances were sufficient to raise the inference that the protected activity was a contributing factor in the unfavorable action.
      6. If the alleged protected activity is that the employee provided information, it *does not matter* whether the employer actually violated the specified laws and regulations; the employee must only have an objectively reasonable belief that the employer’s conduct constitutes such a violation. 18 U.S.C. § 1514A(a)(1); *Wiest v. Lynch*, 710 F.3d 121 (3d Cir. 2013). But mere speculation is insufficient. *Safarian v. American DG Energy, Inc.*, 2014 U.S. Dist. LEXIS 59684 (D.N.J. Apr. 30, 2014).
      7. **Sarbanes-Oxley Section 1107** – imposes criminal penalties for retaliation against an employee who reports accounting fraud (or any federal offense) to a law enforcement officer. 18 U.S.C. § 1513(e).
2. Dodd-Frank Section 922 added Section 21F of the Securities Exchange Act of 1934 in July 2010.
   1. Required the SEC to establish a whistleblower program to pay financial rewards to individuals who provide information about possible securities violations to the SEC.
   2. Unlike with the Insider Trading Bounty program, this program would not entrust discretion in paying these awards to the SEC. The statute mandates payment of 10-30% of the monetary sanctions from an enforcement action generated by a whistleblower’s tip. Section 21F(b)(1).
   3. Intense lobbying effort regarding the ensuring rules, largely around whether whistleblowers should first be required to report violations to corporate compliance departments before reporting them to the SEC. Ultimately, the Commission wrote the whistleblower rules not to require internal reporting, but to encourage it.
   4. Sean McKessy hired in early 2011.
3. **The Bounty Provisions**
   1. Who is affected?
      1. All entities and individuals that are subject to the federal securities laws.
      2. So, public companies and their subsidiaries and affiliates, broker-dealers, investment advisers, investment companies, hedge funds. Even private companies could be liable for aiding and abetting a violation.
      3. Brief SOX aside: *Lawson v. FMR LLC*, 134 S. Ct. 1158 (2014).
         1. Facts: Publicly traded mutual fund had no employees, but the investment adviser to the fund did. Plaintiff employees of the investment adviser blew the whistle on fraud detrimental to mutual fund investors.
         2. Held: Section 1514A protects employees of privately held contractors and subcontractors of public companies.
         3. Maybe less alarming than it first appears.
            1. *Anthony v. Northwestern Mut. Life Ins. Co.*, 2015 U.S. Dist. LEXIS 118961 (N.D.N.Y. Sept. 8, 2015) (rejecting claim because Section 1514A is concerned with public company fraud, and the whistleblowing must relate to the contractor's provision of services to the public company).
            2. *Gibney v. Evolution Mktg. Research, LLC*, 25 F. Supp. 3d 741 (E.D. Pa. June 11, 2014) (rejecting claim because Plaintiff employee of private contractor alleged fraud by that contractor *against* public company, not *by* the public company).
   2. **Who is eligible?**
      1. a whistleblower,
      2. who voluntarily provides the SEC,
      3. with original information,
      4. that leads to a successful enforcement action by the Commission resulting in monetary sanctions of more than $1 million arising out of the same core facts,
      5. is eligible for an award of 10% to 30% of any amounts recovered.
   3. **“Whistleblower”**
      1. someone who, alone or jointly with others, provides the Commission with information that relates to a possible violation of the federal securities laws or rules (including any rules or regulations thereunder) that has occurred, is ongoing, or is about to occur. Rule 21F-2(a)(1); Section 21F(a)(6).
      2. But as to “about to occur,” query whether you’d have any sanctions to generate an award.
      3. The whistleblower must be an individual; a company or another entity is not eligible. Rule 21F-2(a)(1); *see also* Section 21F(a)(6)
      4. A whistleblower may remain anonymous when reporting to the SEC, but must report through an attorney. Rule 21F-9(c); Section 21F(d)(2)(A).
   4. **“Voluntary”** – All information must be “voluntarily” provided to the Commission. Rule 21F-3(a)(1); Section 21F(b)(1). Basically, before you get a subpoena or some other pre-emptive request from the government for the information. Rule 21F-4(a).
   5. **“Original”**
      1. All information provided must be original. Rule 21F-3(a)(2); Section 21F(b)(1). To be original, the information must be based on the whistleblower’s independent knowledge or independent analysis, and it must not already be known to the Commission.
      2. ***Independent knowledge*** is defined as factual information in an individual’s possession that is not derived exclusively from publicly available sources. A whistleblower may gain independent knowledge from his or her own experience, communications and observations in his or her business or social interaction. Rule 21-4(b)(2); *see also* Section 21F(a)(3).
      3. The SEC said in its Adopting Release, “[W]e do not believe that ‘independent knowledge’ should be further limited to direct, first-hand knowledge. Such an approach could prevent the Commissions from receiving valuable information about possible violations from whistleblowers who are not themselves involved in the conduct at issue, but who learn about it through their observations, relationships, or personal diligence.” SEC Rules Implementing the Whistleblower Provisions of Section 21F of Securities Exchange Act of 1934, SEC Release No. 34-64545, 76 Fed. Reg. 34,300, 34,312 (May 25, 2011) [hereinafter SEC Adopting Release].
      4. ***Independent analysis*** means an individual’s own “analysis, whether done alone or in combination with others.” “Analysis” is further defined as an individual’s “examination and evaluation of information that may be publicly available, but which reveals information that is not generally known or available to the public.” Rule 21F-4(b)(3). The SEC explained that the independent analysis condition requires that the “whistleblower do more than merely point the staff to disparate publicly available information that the whistleblower has assembled, whether or not the staff was previously ‘aware of’ the information.” SEC Adopting Release, 76 Fed. Reg. at 34,312. An independent analysis requires some additional evaluation, insight, or assessment of the public information.
   6. **Successful Enforcement Action**
      1. The information provided must lead to a successful enforcement action that results in monetary sanctions of more than $1 million. Rule 21F-3(a)(4); Section 21F(b)(1).
      2. This can happen in a number of situations:
         1. First, if the information causes the staff to open an investigation, reopen an investigation, or inquire about different conduct as part of a current examination or investigation, and the SEC brings a successful action based at least in part on the conduct subject of the original information. Rule 21F-4(c)(1). In determining whether this standard is met, the SEC may consider several factors including:
            1. allegations that formed the basis for any of the SEC’s claims in the judicial or administrative action;
            2. provisions of the securities laws that the SEC alleged as having been violated in the judicial or administrative action;
            3. culpable persons or entities (as well as offices, divisions, subsidiaries or other subparts of entities) that the SEC named as defendants, respondents or uncharged wrongdoers in the judicial or administrative action; or
            4. investors or a defined group of investors that the SEC named as victims or injured parties in the judicial or administrative action. SEC Adopting Release, 76 Fed. Reg. at 34,324.
         2. Second, when the WB provides information about conduct already under examination or investigation that is considered original and that significantly contributes to the success of the action or leads the investigation or examination in a new direction. Rule 21F-4(c)(2). Under its rules, the SEC will look at factors such as whether the information allowed it to bring:
            1. a successful action in significantly less time or with significantly fewer resources;
            2. additional successful claims; or
            3. successful claims against additional individuals or entities. SEC Adopting Release, 76 Fed. Reg. at 34,325.
      3. **Calculating the Amount Recovered**
         1. The $1 million threshold can be met by civil money penalties, disgorgement payments, and prejudgment interest totaling more than $1 million in one or more related SEC actions. Rule 21F-4(e).
         2. The rules permit the aggregation of multiple cases that arise out of the same nucleus of operative facts. SEC Adopting Release, 76 Fed. Reg. at 34,327.
         3. Once the $1 million threshold has been passed, the amount of the award may also be based on related actions brought by other government agencies such as criminal prosecutions by the Department of Justice. Rule 21F-4(d); Rule 21F-3(b).
   7. **People excluded from whistleblowers awards**
      1. **Principals** – An officer, director, trustee, or partner of a company who receives information about the alleged misconduct from a company employee or from the company’s internal compliance process is excluded from receiving an award. Rule 21F-4(b)(4)(iii)(A).
      2. **Attorneys** – not permitted to use information obtained from client engagements or attorney-client privileged information to make whistleblower claims themselves. Rule 21F-4(b)(4)(i), (ii).
         1. This exclusion applies to in-house attorneys who may be eligible for an award only to the extent that their disclosures are consistent with their ethical obligations and SEC rules. SEC Adopting Release, 76 Fed. Reg. at 34,315.
         2. This exclusion extends to non-attorneys who learn information through confidential attorney-client communications. SEC Adopting Release, 76 Fed. Reg. at 34,315.
         3. But . . . as noted in the SEC’s Adopting Release, the rule does not affect the existing Standards of Professional Conduct which “permit[] attorneys representing issuers of securities to reveal to the [SEC] ‘confidential information related to the representation to the extent the attorney reasonably believes necessary’
            1. to prevent the issuer from committing a material violation that is likely to cause substantial injury to the financial interest or property of the issuer or investors;
            2. to prevent the issuer, in a [SEC] investigation or administrative proceeding, from committing perjury, suborning perjury, or committing any act that is likely to perpetrate a fraud upon the Commission; or
            3. to rectify the consequences of a material violation by the issuer that caused, or may cause, substantial injury to the financial interest or property of the issuer or investors in the furtherance of which the attorney’s services were used.” 17 C.F.R. § 205.3(d)(2).
         4. Moreover, attorneys are eligible for an award if the disclosure to the Commission does not violate applicable state bar rules; for example, the submission was based on the waiver of privilege or a crime-fraud exception. Rule 21F-4(b)(4)(i); *see also* SEC Adopting Release, 76 Fed. Reg. at 34,314 n.120 (citing California Evidence Code § 956 (“There is no privilege under this article if the services of the lawyer were sought or obtained to enable or aid anyone to commit or plan to commit a crime or fraud.”))
      3. **Compliance personnel** – Employees whose principal duties include compliance or internal audit functions, or individuals retained by a company to perform compliance or audit functions, are not eligible for an award. Rule 21F-4(b)(4)(iii)(B). The rules do not clearly extend these exclusions to other company employees involved in control or accounting functions, unless the Commission construes “compliance” to include
      4. accounting and financial reporting personnel.
      5. **Individuals retained to conduct an inquiry or investigate possible law violations** – not eligible for an award. Rule 21F-4(b)(4)(iii)(C).
      6. **Accountants** – employees of a public accounting firm who obtain information through an engagement required under the federal securities laws – such as a financial statement audit, a broker-dealer annual audit, or an engagement for an investment advisor related to compliance with the custody rule – are not eligible for an award if that information relates to a violation by the engagement client, et al. Rule 21F-4(b)(4)(iii)(D).
         1. Also, public company auditors are ineligible for awards where the information was obtained through an audit of a company’s financial statements, and making a whistleblower submission would be contrary to the requirements for auditor reporting of potential illegal activity specified in section 10A of the Exchange Act. Rule 21F-8(c)(4).
      7. **Other Exclusions**
         1. Information that was obtained in a way that is determined by a U.S. court to have violated federal or state criminal law is also excluded. Rule 21F-4(b)(4)(iv).
         2. Foreign government officials, including employees of state-owned enterprises. Rule 21F-8(c)(2).
         3. Anyone who obtained information from persons subject to these exclusions is also excluded. Rule 21F-8(c)(6).
      8. **Exceptions to Exclusions**. The rules provide that an otherwise excluded whistleblower will be eligible for an award if:
         1. he or she has a reasonable basis to believe that disclosure is necessary to prevent the company from engaging in conduct that is likely to cause substantial financial injury to the company or investors;
         2. he or she has a reasonable basis to believe the company is engaging in conduct that will impede an investigation of the misconduct; or
         3. at least 120 days have elapsed since the whistleblower provided the information through the company’s internal reporting system. Rule 21F-4(b)(4)(v).
         4. But these exceptions don’t apply to attorneys. Rule 21F-4(b)(4)(v).
   8. **Factors Considered in Determining the Amount of an Award**
      1. If all these requirements are satisfied, the SEC is required to pay the whistleblower an award of 10% to 30% of the amount recovered as result of the tip. But the rules use a number of factors to move the award up or down within that range.
      2. **Increasing Factors**
         1. **Significance of the information** – Section 21F(c)(1)(B)(i)(I). In considering this factor, the Commission can take into account:
            1. the nature of the information provided, including the reliability and completeness of the information, and
            2. the usefulness of the information. Rule 21F-6(a)(1); *see also* Section 21F(c)(1)(B).
         2. **Degree of Assistance Provided** – Section 21F(c)(1)(B)(i)(II). Factors include:
            1. Extent of the assistance, including helping to explain complex transactions, interpreting evidence, or identifying new and productive lines of inquiry;
            2. timeliness of the initial report to the SEC or an internal compliance program;
            3. staff resources conserved;
            4. encouraging or authorizing others to assist;
            5. efforts to remediate the harm caused; and
            6. any unique hardships experienced by the whistleblower. Rule 21F-6(a)(2).
         3. **Programmatic Interest of SEC** – Section 21F(c)(1)(B)(i)(III). The Commission may take into account:
            1. Enhancement of the SEC’s ability to enforce the federal securities laws and protect investors;
            2. if an award would encourage the submission of high quality tips;
            3. if the subject matter of the action is an SEC priority;
            4. regulated entities or fiduciaries involved;
            5. exposing an industry-wide practice;
            6. the type and severity of the violations;
            7. the age and duration of misconduct;
            8. the number of violations and the isolated, repetitive, or ongoing nature of the violations; and
            9. the dangers to investors or others presented by the underlying violations involved in the enforcement action. Rule 21F-6(a)(3).
         4. **Participation in Internal Compliance Programs** – The SEC may take into account:
            1. Whether a whistleblower reported the possible violations through internal compliance procedures before reporting them to the SEC; and
            2. whether a whistleblower assisted any internal investigation concerning the reported violations. Rule 21F-6(a)(4).
         5. **120-Day Look Back Provision** – If the whistleblower provides information to an internal compliance program, the whistleblower will have a 120-day period to alert the SEC of the same information and still be considered to have provided original information on Day 1. Rule 21F-4(b)(7).
      3. **Decreasing Factors**
         1. **Whistleblower Culpability** – The SEC may take into account:
            1. role in the violations;
            2. education, training, experience, and position of responsibility;
            3. acting with scienter;
            4. financial benefit;
            5. recidivism;
            6. egregiousness of the underlying fraud; and
            7. knowingly interference with the SEC’s investigation. Rule 21F-6(b)(1).
         2. **Delay in Reporting Violation** – Factors include:
            1. Failure to report or prevent violations after becoming aware of the relevant facts;
            2. Reporting only after learning about a related investigation or enforcement action; and
            3. Any legitimate reason to delay reporting. Rule 21F-6(b)(2).
         3. **Interference with Internal Compliance Programs** – Factors include whether the whistleblower knowingly:
            1. interfered with an entity’s established legal, compliance, or audit procedures to prevent or delay detection of the reported violation;
            2. made any material false, fictitious, or fraudulent statements or representations; and
            3. provided any false writing or document knowing the writing or document contained any false, fictitious, or fraudulent statements or entries. Rule 21F-6(b)(3).
         4. **Potential Adverse Incentives** – The CFTC only will consider whether potential adverse incentives may result from oversized awards. 17 C.F.R. § 165.9(a)(5).
   9. **Treatment of Culpable Individuals** –

* + 1. No amnesty for whistleblowers. Also, those who are convicted of a criminal violation that is related to the action cannot receive an award. Rule 21F-15; Rule 21F-8(c)(3); Section 21F(c)(2)(B).
    2. In calculating the $1 million threshold, the SEC will exclude any monetary sanctions the whistleblower has been ordered to pay. Rule 21F-16.
    3. But the rules do not categorically exclude culpable whistleblowers from award eligibility. SEC Adopting Release, 76 Fed. Reg. at 34,350.
  1. **Whistleblower Confidentiality** – The rules allow anonymous reporting as long as the whistleblower is represented by an attorney. Rule 21F-7(b); Section 21F(d)(2)(A).
     1. The SEC has said it will not disclose information that could reasonably be expected to reveal the identity of the whistleblower, except under certain circumstances. Rule 21F-7; Section 21F(h)(2).

1. **The Anti-Retaliation Provisions**
   1. New cause of action for whistleblowers. No employer may discharge, demote, suspend, threaten, harass, directly or indirectly, or in any other manner discriminate against, a whistleblower in the terms and conditions of employment because of any lawful act undertaken by the whistleblower in:
      1. providing information to the SEC in accordance with the rules;
      2. assisting in any investigation or judicial or administrative action of the Commission based upon or related to such information; or
      3. making disclosures that are protected under the rules, SOX, or any other law, rule, or regulation subject to the jurisdiction of the Commission. Section 21F(h)(1); Rule 21F-2(b)(1); *see also* Section 21F(a)(6).
   2. Dodd-Frank also significantly increased the employment rights of purported whistleblowers beyond those adopted in the Sarbanes-Oxley Act of 2002 (SOX). 18 U.S.C. § 1514A.
      1. Extends the deadline to file a charge with the Department of Labor from 90 to 180 days and provides that parties to a SOX retaliation claim have a right to trial by jury. 18 U.S.C. § 1514A(b).
      2. It also extends whistleblower protection to employees of affiliates and subsidiaries of publicly traded companies. 18 U.S.C. § 1514A(a).
   3. The anti-retaliation protections apply even if the whistleblower is not ultimately entitled to an award. Rule 21F-(b)(1)(iii).
      1. The whistleblower must have a ‘reasonable belief’ that the information demonstrates a possible violation. SEC Adopting Release, 76 Fed. Reg. at 34,303 & n.33 (citing *Livingston v. Wyeth, Inc*., 520 F.3d 344, 352 (4th Cir. 2008); *Clover v. Total Sys. Servs., Inc.*, 176 F.3d 1346, 1351 (11th Cir. 1999)).
   4. **Dodd-Frank and SOX Retaliation Claims** – So, the new cause of action protects whistleblowers who make disclosures that are protected by SOX. This presents an interpretive problem because SOX protects internal reporting, while the definition of “whistleblower” in the Dodd-Frank Act is limited to “any individual who provides . . . information relating to a violation of the securities laws to the Commission[.]” Section 21F(a)(6). So do the Dodd-Frank anti-retaliation provisions kick in upon internal reporting?
      1. Second Circuit says yes. *Berman v. Neo@Ogilvy LLC*, 2015 U.S. App. LEXIS 16071 (2d Cir. 2015).
      2. Fifth Circuit says no. *Asadi v. G.E. Energy (USA), LLC*, 720 F.3d 620 (5th Cir. 2013). (Also the dissent in *Berman*.)
      3. Under the Second Circuit’s approach, Dodd-Frank Act retaliation claims could effectively subsume SOX retaliation claims. Remember, there are substantial benefits to bringing retaliation claims under Dodd-Frank rather than under SOX.
         1. A whistleblower must exhaust administrative remedies under SOX by filing a complaint with OSHA, while Dodd-Frank allows immediate suit in federal court.
         2. SOX requires that a whistleblower file his charge with OSHA within 180 days, whereas the limitations period to sue in court under Dodd-Frank is six years (or three years after the material facts were known or reasonably should have been known to the employee, but in no event longer than ten years).
         3. Dodd-Frank allows employees to recover double back pay, whereas only actual back pay is available under SOX. Compare 18 U.S.C. § 1514A with Section 21F(h).
         4. Dodd-Frank’s final rules contain a provision that purports to prevent employers from enforcing confidentiality agreements to prevent whistleblower employees from cooperating with the SEC. Rule 21F-17(a).
   5. **SEC Enforcement** of the Anti-Retaliation Provisions.
      1. The SEC Adopting Release said the SEC had enforcement authority for violations by employers who retaliate against whistleblowers. SEC Adopting Release, 76 Fed. Reg. at 34,304. This provision surprised observers, as the Department of Labor historically has not brought enforcement actions under SOX.
      2. ***In re Paradigm Capital Management***, Exchange Act. Rel. No. 72393 (June 16, 2014).
         1. Paradigm engaged in principal transactions with an affiliated broker-dealer, without providing effective disclosure to a hedge fund client advised by Paradigm.
         2. Mar. 2012: Paradigm’s then-head trader made a whistleblower submission to the SEC that revealed these principal transactions.
         3. July 2012:  Paradigm tells trader: don’t bother coming in tomorrow. Over the next month, the trader is marginalized and removed from his role, but not fired.
         4. Action brought under Section 21F(h).
   6. Anti-retaliation protections cannot be waived. “Any condition, stipulation, or provision binding any person to waive compliance with any provision of this chapter or of any rule or regulation thereunder . . . . shall be void.” 15 U.S.C. § 78cc(a). Also, any agreement that prevents employees or other individuals from disclosing information about possible securities laws violations is unenforceable under the Whistleblower Rules. Rule 21F-17(a).
      1. Also in 2014, Sean McKessy warned against companies writing severance agreements to buy their former employees’ silence with post-employment benefits. “And if we find that kind of language, not only are we going to go to the companies, we are going to go after the lawyers who drafted it.” Brian Mahoney, SEC Warns In-House Attorneys against Whistleblower Contracts, Law360 (Mar. 14, 2014).
      2. Early this year, the WSJ reported that the SEC had sent a voluntary request letter asking a number of companies “to turn over every nondisclosure agreement, confidentiality agreement, severance agreement and settlement agreement they entered into with employees since Dodd-Frank went into effect, as well as documents related to corporate training on confidentiality.” The letter also asked for “all documents that refer or relate to whistleblowing” and a list of terminated employees.” Rachel Louise Ensign, SEC Probes Companies’ Treatment of Whistleblowers, Wall Street Journal (Feb. 25, 2015).
      3. ***In re KBR, Inc.***, Exch. Act Rel. No. 74619 (Apr. 1, 2015).
         1. The agreements at issue arose out of internal investigations at KBR and required witnesses in those investigations to keep quiet about what they learned from them.
         2. The language read this way: “I understand that in order to protect the integrity of this review, I am prohibited from discussing any particulars regarding this interview and the subject matter discussed during the interview, without the prior authorization of the Law Department. I understand that the unauthorized disclosure of information may be grounds for disciplinary action up to and including termination of employment.”
         3. Language written before Dodd-Frank’s passage in 2010. It apparently never prevented a KBR employee from communicating with the Commission. And it doesn’t refer to the SEC as a prohibited destination for the confidential information.
         4. KBR’s new language: “Nothing in this Confidentiality Statement prohibits me from reporting possible violations of federal law or regulation to any governmental agency or entity, including but not limited to the Department of Justice, the Securities and Exchange Commission, the Congress, and any Inspector General, or making other disclosures that are protected under the whistleblower provisions of federal law or regulation. I do not need the prior authorization of the Law Department to make any such reports or disclosures and I am not required to notify the company that I have made such reports or disclosures.”
      4. The CFTC declined to exercise enforcement authority over retaliation claims.
   7. **Extraterritorial Application**
      1. In the only appellate decision to date examining the question of extraterritorial application of the SOX antiretaliation provision, the First Circuit applied the traditional presumption against the extraterritorial application of Congressional statutes. *Carnero v. Boston Scientific Corp.*, 433 F.3d 1 (1st Cir. 2006).
      2. The Second Circuit went the same way as to the Dodd-Frank anti-retaliation provisions. *Liu v. Siemens AG*, 763 F.3d 175 (2d Cir. 2014).
   8. **SEC Communications with Whistleblowers and Attorney-Client Privilege**
      1. The rules authorize SEC staff to communicate directly with whistleblowers who are directors, officers, members, agents, or employees of a company who have counsel, without first seeking the consent of the company’s counsel. Rule 21F-17(b).
      2. Rule is designed to address Rule of Professional Conduct 4.2 on communications with people represented by counsel.
      3. The SEC assures us that “nothing about this rule authorizes the staff to depart from the Commission’s existing procedures and practices when dealing with potential attorney-client privileged information.” SEC Adopting Release, 76 Fed. Reg. at 34,352.
   9. **Arbitration** and Alternative Dispute Resolution.
      1. Dodd-Frank prohibits predispute arbitration agreements governing claims under the CFTC, Bureau of Consumer Financial Protection, and SOX whistleblower provisions.
      2. That is significant for broker-dealers, which frequently require their employees to sign arbitration agreements as part of the standard Form U-4 that is used to register broker-dealer representatives with the SROs.
      3. But Dodd-Frank does not bar predispute agreements to arbitrate the “core” whistleblower cause of action. Section 21F. This is also potentially significant, because retaliation claims can spawn expensive parallel litigation. If enforced by the courts, predispute arbitration agreements concerning Dodd-Frank’s anti-retaliation regime could minimize the publicity of retaliation claims and reduce potential exposure.
2. **Practical Considerations.** Companies should consider the following four critical components of an effective compliance program: (i) a culture of compliance; (ii) internal reporting procedures; (iii) human resources procedures; and (iv) internal investigation practices.
   1. **Culture of Compliance**.

* + 1. As regulated entities, broker-dealers and investment advisers are required to have policies and procedures reasonably designed to prevent and detect violations of law.
       1. For example, potential liability for failure to supervise associated persons under Section 15(b)(6)(A)(i) of the Exchange Act (broker-dealers) and Advisers Act Section 203(e) (investment advisers).
       2. Requirements to maintain policies and procedures designed to avoid the misuse of material, nonpublic information (Section 15(g) of the Exchange Act) and all investment adviser violations (Section 204A of the Advisers Act).
       3. And, under FINRA Rule 3110, FINRA member firms must establish, maintain, and enforce written supervisory control policies and procedures.
    2. Creating an atmosphere in which employees understand that they are to rigorously adhere to the law and company rules, and promptly report potential misconduct, will greatly alleviate many of the issues raised here.
    3. In the event of an enforcement investigation, the company’s compliance culture and the efficacy of its compliance programs are also important factors in whether a firm will be sanctioned and the nature of any sanction imposed.
       1. *See* Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement Decisions, Exchange Act Release No. 44,969 (Oct. 23, 2001) (“Seaboard” Report);
       2. U.S. Sentencing Guidelines Manual § 8C2.5(f)(2) (credit for an effective compliance program)
       3. In September, the Justice Department hired Hui Chen, the former head of anti-bribery and corruption compliance at Standard Chartered, as its new compliance counsel.
    4. Promoting Compliance – Consider whether you have an environment that encourages employees to prevent wrongdoing and speak up when they see it.
    5. **Codes of Conduct and Training**
       1. Sarbanes-Oxley Section 406 all but requires a code of conduct.
       2. The listing standards for the NYSE and NASDAQ have express requirements. *See* NYSE Listed Company Manual § 303A.10; NASDAQ Corporate Governance Requirements § 5610.
       3. Broker-dealers, investment advisers, and other regulated entities are required to have written policies and procedures governing compliance matters, supervision, and other aspects of their business.

* + - 1. What to do with them?
         1. Companies should periodically review their codes of conduct and WSPs to see if any changes are appropriate, particularly with respect to encouraging communications between employees and compliance personnel.
         2. Deliver codes of conduct to all employees and make them available online and in multiple languages.
         3. Give training on the code of conduct or upon hiring and periodically thereafter.
         4. Require employees to sign an annual certification saying they’re familiar with the code of conduct and have received training on these topics. FINRA Rule 3010(a)(7) requires an annual compliance meeting for broker-dealers.
         5. *See United States v. Garth Peterson*, 12-cr-224 (E.D.N.Y. 2012) (charging managing director Peterson, but not employer Morgan Stanley & Co., with FCPA violations, after Peterson received at least 35 FCPA compliance reminders from the company); *SEC v. Garth Peterson*, No. 12-cv-2033 (E.D.N.Y. 2012) (same).
  1. **Internal Reporting Procedures**. Consider several measures to further promote and encourage internal reporting.
     1. Accessible Internal Reporting Systems – Internal reporting should be made available to employees by providing several methods of reporting, including toll-free hotlines and a web-based form to accept anonymous allegations. A company’s reporting mechanisms should be available twenty-four hours a day and in appropriate language. Also consider benchmarking your internal reporting systems against those of similar companies in their industry. If reports are comparably low, consider why.
     2. Consider integrating your Dodd-Frank whistleblower intake with your reporting to the audit committee under Sarbanes-Oxley Section 301. You may already have an infrastructure in place.
     3. Communicating Importance of Internal Reporting – Consider creative ways to raise employee awareness of the importance of reporting compliance. Get senior management to convey that the company wants to hear about problematic issues.
  2. **Human Resources** – plays an important role in protecting whistleblowers and seeing that employment decisions are made without regard to any protected activity. At times HR can address employees’ personnel concerns before they spill over into whistleblowing activity.
     1. Screening New Employees – HR should screen prospective new hires to identify and vet red flags, consistent with applicable laws.
     2. Employee Evaluations – Incorporate adherence to the code of conduct, including the use of internal reporting procedures, into employee evaluations.
     3. Supervisory Training – Prepare managers to recognize actual violations. Hard to do! But failure to take legitimate reports seriously will discourage employees from reporting internally and could increase a firm’s legal exposure.
     4. Stop problems before they start – Be on the watch for working relationships where an employee believes he or she is being treated unfairly by superiors. Investigate and address the circumstances promptly to reduce the likelihood that the employee will seek assistance outside of the company by making a whistleblower complaint.
     5. Exit Forms and Separation Releases – Obtain confirmation from departing employees that they have disclosed to the company any misconduct of which they are aware so it can be addressed appropriately. Separation agreements should include acknowledgments of employee rights to file charges, provide truthful information, and otherwise assist governmental authorities so they are not misinterpreted as impeding these rights, while at the same time waiving individual relief to the maximum extent permitted.
  3. **Internal Investigations** – Develop a system to respond quickly to allegations of impropriety and periodically review that system. Upon receiving a tip, a company only has 120 days before an employee can report to the SEC without losing “first in line” status. At the same time, be cautious and deliberative in conducting investigations.
     1. **Investigative Plans** – Create an investigative plan in advance to respond to allegations of possible violations. Perhaps obviously, adjust attention and resources according to the seriousness of the allegations. In some cases, it may be important that the investigation be conducted by someone with an independent perspective, such as when there are allegations involving senior management, so as to give external confidence to the results of the investigation. Companies should consider identifying in advance the types of allegations they intend to use outside counsel to investigate, so the investigation can commence promptly. Public companies should also review the types of whistleblower complaints that they require to be promptly reported to the audit committee and determine whether any changes to these procedures are appropriate.
     2. **Keeping Whistleblowers Informed** – Whistleblowers who are left in the dark may assume the worst about the ramifications of their reports. Consider keeping internal whistleblowers informed on the status and outcome of the investigation, consistent with needs for confidentiality.
     3. **Employee Interviews** – Avoid revealing specific allegations of wrongdoing and underlying facts that support the allegations during employee interviews, to the extent possible. Also consider advising employees that they have an obligation to be candid with the company.
     4. **Using Counsel** – If appropriate to facilitate legal advice, companies should consider having an attorney conduct or participate in interviews. Be sure that the privilege is not waived by providing an *Upjohn* warning at the outset of each interview. *See* *Upjohn Co. v. United States*, 449 U.S. 383 (1981) (communications between company counsel and employees are privileged, but the privilege is owned by the company and not the individual employee). The warning has two purposes: (1) it removes any doubt that the lawyer speaking to the employee represents the company, and not the employee; and (2) it makes clear that only the company, and not the employee, can waive any privilege associated with the communication.
     5. **Policies Regarding Privileged and Confidential Information** – It is possible foreseeable that whistleblowers will disclose confidential and proprietary business or customer information to the government without corporate authorization. Companies should take steps to prevent the misuse of confidential information by third parties and be prepared to advise the SEC that an employee’s disclosure of privileged information was unauthorized and not a waiver by the company.
     6. **Potential State Action Issue**
        1. *United States v. Stein*, 541 F.3d 130 (2d Cir. 2008) – “We hold that KPMG’s adoption and enforcement of a policy under which it conditioned, capped and ultimately ceased advancing legal fees to defendants followed as a direct consequence of the government's overwhelming influence, and that KPMG’s conduct therefore amounted to state action. We further hold that the government thus unjustifiably interfered with defendants’ relationship with counsel and their ability to mount a defense, in violation of the Sixth Amendment, and that the government did not cure the violation. Because no other remedy will return defendants to the status quo ante, we affirm the dismissal of the indictment as to all thirteen defendants.”
        2. *Gilman v. Marsh & McLennan Companies, Inc.*, 2016 U.S. App. LEXIS 10937 (2d Cir. June 16, 2016) – “Gilman and McNenney urge that we adopt, in effect, this categorical rule: acts that are taken by a private company in response to government action, and that have as one goal obtaining better treatment from the government, amount to state action. But a company is not prohibited from cooperating, and typically has supremely reasonable, independent interests for conducting an internal investigation and for cooperating with a governmental investigation, even when employees suspected of crime end up jettisoned. A rule that deems all such companies to be government actors would be incompatible with corporate governance and modern regulation.”
        3. *Individual Accountability for Corporate Wrongdoing*, Memorandum from Deputy Attorney General Sally Quillian Yates (Sept. 9, 2015) (the “Yates Memo”).
           1. Among other things: “To be eligible for anv cooperation credit, corporations must provide to the Department all relevant facts about the individuals involved in corporate misconduct.”
        4. What if a company doesn’t threaten to fire non-cooperating employees until after the government tells the company to do everything it can to find culpable individuals?
           1. For example, say an anonymous whistleblower alerts the Justice Department or the SEC to a foreign bribery scheme. You first learn of the issue when a prosecutor says, “We have evidence of anti-bribery violations, and John Doe and Jane Smith are possible targets. Per the Yates Memo, we want everything you can find about their business overseas.”
           2. Is that scenario close to the pressure prosecutors applied in the Stein case, where the government did overstep and coerce KPMG to do its bidding? As the appellate court noted in *Stein*, KPMG’s decision to cut off legal fees “was a direct consequence of the government’s overwhelming influence.”
           3. The Yates Memo could qualify as government influence. But remember that KPMG reversed its policy of covering employees’ legal fees after being pushed by prosecutors to do so. If you want to avoid *Stein*-like trouble, take a hard line from the start: that stonewalling an investigation into misconduct will get an employee fired.
           4. But also remember that employees are human beings and that taking such a hard line could scare them, especially if they are only peripheral to the investigation or were somehow coerced into wrongdoing by a guilty supervisor. *See* Matt Kelly, *Internal Investigations Just Got a Big Boost*, Radical Compliance Blog (June 21, 2006).

1. **Implications for Enforcement Practice** – The rules are intended to supplement the Commission’s efforts to encourage self-reporting of securities law violations. In 2010, the SEC authorized the staff to enter into cooperation agreements with individuals and to resolve cases with entities that self-report violations and undertake remedial measures through non-prosecution agreements and deferred prosecution agreements.
   1. **Self-Reporting** – Historically, the SEC has said that it will consider lower sanctions or non-prosecution for companies who promptly self-report potential violations. Those lower sanctions have always been very hard to quantify. A company investigating a possible violation must bear in mind the possibility that a whistleblower may seek to “win the race” to the SEC, which could then adversely affect the amount of “credit” the company may claim for itself.
   2. **Protect Privileges** – For several decades, practitioners have sought to enter into “limited waiver” agreements under which company counsel sought to provide privileged information and protected attorney work product to the Commissions while maintaining the privilege or protection as to third parties. Courts have not always honored such limited waiver agreements. Nevertheless, companies who wish to cooperate and share the results of an internal investigation and the evidence collected can defend against a subsequent claim of waiver in a private civil action by carefully defining the scope of communications with the Commission, limiting the amount of attorney work product disclosed, and guarding against unauthorized disclosures of privileged information or attorney work product.
   3. **Assess Public Disclosure Issues** – Whistleblowers may raise issues that suggest that a company’s previous periodic reports or press releases are inaccurate. These issues may also have implications for the accuracy of selling documents, prospectuses, or other sales literature distributed to customers or used by sales personnel. They may also identify previously unknown contingent liabilities. Broker-dealers and investment advisers also may need to assess whether corrective or additional disclosures to customers are required.